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Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY,
Petitioner,
v.
GUY T. HELVERING, Commissioner of Internal Revenue.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion in the United States Board of Tax Appeals is reported in *Evelyn F. Gregory* v. *Commissioner of Internal Revenue,* 27 B. T. A. 223 (R. 8); and the opinion of the Circuit Court of Appeals for the Second Circuit is reported in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Evelyn F. Gregory,* 69 Fed. (2d) 809 (R. 33).

JURISDICTION

This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stats. 938. See *Old*

Colony Trust Co. v. *Commissioner*, 279 U. S. 716. The date of the judgment sought to be reviewed is March 26, 1934 (R. 37).

QUESTION PRESENTED

Is a given transaction to be considered as falling within or without the statutory definition of reorganization, dependent on whether or not it was undertaken with the motive of minimizing tax liability?

More specifically, is a transfer by a corporation of a part of its assets to another corporation in exchange for all of its stock, so that immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, not a "reorganization" within the meaning of Section 112 (i) (1) (B) of the Revenue Act of 1928, if the purpose of the transaction is to pay the minimum tax and the transferee corporation is shortly dissolved?

STATUTE INVOLVED

The statute directly involved is Section 112 (i) (1) (B) and (j) of the Revenue Act of 1928 (45 Stat. 791, 818, c. 852) as follows:

> **(i) Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term "reorganization" means . . . (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, . . .
>
> **(j) Definition of control.**—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Collateral provisions of the statute are set forth in the appendix hereto (p. 54).

STATEMENT OF CASE

The petitioner had owned for seven years 66 per cent. and for a less period 100 per cent. of the stock of an investment company (R. 18-20). Her cost for the stock was about 43.6 per cent. of its present value. An asset representing one-sixth of the net worth of the company could be sold advantageously and her investment liquidated proportionately, provided the expense of the sale, including taxes, were not excessive. If the company should sell the asset and distribute the proceeds to her, there would be taxes on both of them. If the company should distribute the asset to her as an ordinary dividend and she should sell it, she would be subject to surtax on its entire value. Evidently, if she was to be presently subject to tax only on the profit realized by the liquidation of one-sixth of her investment, any tax on the unrealized profit on the remaining five-sixths being deferred until it should be realized by liquidation or sale, it was necessary to segregate that portion of her investment represented by the asset in question before its sale. The opinion of the Board of Tax Appeals states what was done, as follows (R. 9):

> "The petitioner was the owner of all the outstanding (5,000) shares of the United Mortgage Corporation. Of these, 3,300 shares had been purchased between October 1, 1920, and December 16, 1921, at a cost of $180,000, and 1,700 shares between January 12, 1927, and January 3, 1928, at a cost of $170,000. The United corporation had among its assets 1,000 shares of the Monitor Securities Corporation. On September 18, 1928, the Averill corporation was organized under Delaware law. On September 20, 1928, the United corporation transferred to the Averill corpo-

ration the 1,000 shares of Monitor stock, in consideration for which the Averill corporation issued its shares to the petitioner. On September 24, 1928, the Averill corporation liquidated and dissolved, thus distributing its entire assets, consisting of the Monitor shares, to its only shareholder, the petitioner. On the same date as the liquidation distribution, petitioner sold the Monitor shares for $133,333.33.

In her return, she treated these several transactions as governed by the several reorganization provisions of the statute, and returned as capital net gain derived from the sale price of $133,333.33 the amount of $76,007.88 upon an apportioned cost basis of $57,325.45.

None of the foregoing facts or figures is in dispute, the respondent conceding that, if the petitioner was legally correct in applying the reorganization provisions of the statute to the situation, her computation of gain is correct."

Maintaining that the distribution to her of the Averill stock was pursuant to a reorganization, from which no taxable gain was recognizable, the petitioner computed and reported a capital gain of $76,007.88 upon the distribution to her of the Monitor stock on complete liquidation of the Averill Corporation, as follows (R. 23):

Value United Corporation net assets		$814,064.25
Value Monitor stock included therein		133,333,33
Proportion value Monitor stock to all assets		16.3787%
Proportion value other assets to all assets		83.6213%
Cost to petitioner of United stock		350,000.00
Apportioned cost of old and new stock:		
Averill stock 16.3787% of $350,000		57,325.45
United stock 83.6213% of $350,000		292,674.55
Distribution Monitor stock on Averill dissolution:		
Value Monitor stock	$133,333.33	
Less cost Averill stock	57,325.45	
Gain		$76,007.88

As $57,325.45 of the cost of the United Corporation stock was apportioned to the Averill stock, the petitioner's basis for the United stock upon a subsequent liquidation or sale was reduced by the same amount. The full amount of $133,333.33 having been taken into account in computing the gain on the liquidation of Averill Corporation, no further profit resulted from the subsequent sale of the Monitor stock at the same figure.

The Commissioner of Internal Revenue, disregarding the existence of the Averill Corporation, determined that the petitioner received the Monitor stock as an ordinary dividend from the United Corporation, subject to surtax at the full value of $133,333.33, without any deduction of cost. The Board of Tax Appeals sustained the petitioner's position, on the ground that the Averill Corporation could not be disregarded and accordingly that there was a statutory reorganization "and hence no gain to the petitioner as distributee from the United Corporation of the Averill shares." (R. 9, 11.) The Circuit Court of Appeals, disagreeing with both the Board and the Commissioner, held that the petitioner received the stock of the Averill Corporation (not of the Monitor Corporation) as an ordinary dividend from the United Corporation, taxable at surtax rates, the resulting tax being the same in amount as that determined by the Commissioner. In so holding the Circuit Court of Appeals rejected the petitioner's contention, which had been upheld by the Board of Tax Appeals, that the transfer of the Monitor stock to the Averill Corporation in exchange for the issuance of the stock of the Averill Corporation constituted a "reorganization" as defined in the statute.

SUMMARY OF ARGUMENT

Section 112 (i) (1) (B) of the Revenue Act of 1928, with precise particularity and in identical language with the Revenue Acts of 1924, 1926, 1932 and 1934, defines "reorganization" as a transfer by a corporation of a part of its assets to another corporation if immediately thereafter the transferor corporation or its stockholders or both are in control (that is, hold at least 80 per cent. of the stock) of the transferee corporation. In Section 112 (g) (Appendix, p. 54) the Act permits the distribution free from tax of stock of a corporation "a party to a reorganization" as defined by the statute. It is clear that the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to the petitioner were not subject to tax if the language of the statutory definition of reorganization be accorded its ordinary meaning. In reaching its conclusion that there was not a "reorganization", the Circuit Court of Appeals reasoned that, although a purpose to avoid taxation does not vitiate a transaction, and the Averill Corporation had a juristic personality which could not be ignored, nevertheless "it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition."

The Circuit Court of Appeals erred in holding that the distribution to Mrs. Gregory of the stock of Averill Corporation constituted a taxable dividend, despite the provisions of Section 112 (g) of the 1928 Act; it erred in holding that the transfer by United Mortgage Corporation of a part of its assets to Averill Corporation, in exchange for the issue of all the stock of Averill Corporation, was not a reorganization within the definition of "reorganization" in Section 112 (i) (1) (B) of the 1928

Act; it erred in refusing to give effect to the plain language of the statute and its specific definition of reorganization upon the assumption that Congress intended to exclude a business transaction undertaken to minimize taxes on the disposition of an investment.

The petitioner accordingly maintains the following propositions:

I. No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation, pursuant to a reorganization, without the surrender by her of the stock of United Mortgage Corporation; but gain was recognizable on the distribution to her of the Monitor stock upon complete liquidation of Averill Corporation; for

II. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the express definition of the statute;

III. Such transfer was a reorganization within the intent of Congress; for

A. The intent of Congress to defer recognition of gain in formal intercorporate readjustments is indicated by the history of the reorganization provisions of the revenue acts;

B. Congress did not intend that reorganizations be judged by the motives inducing them;

C. Nevertheless the disposition of investments with the greatest ultimate profit is a reason germane to the conduct of business; and

D. When Congress has intended the purpose of a transaction to control it has expressly so provided;

IV. Such transfer was a reorganization within the regulations and rulings of the Treasury Department; and

V. Such transfer was a reorganization within the decisions of the Courts.

In conclusion, the decision of the Board of Tax Appeals was correct and that of the Circuit Court of Appeals was erroneous.

ARGUMENT

I.

No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation, pursuant to a reorganization, without the surrender by her of the stock of United Mortgage Corporation; but gain was recognizable on the distribution to her of the Monitor stock upon complete liquidation of Averill Corporation.

In 1928 the petitioner owned all the stock of the United Mortgage Corporation, which held among its assets stock of the Monitor Corporation. A new corporation, the Averill Corporation, was organized. In exchange for the transfer to it by the United Corporation of stock in the Monitor Corporation, the Averill Corporation issued all of its stock, which was distributed to Mrs. Gregory, the sole stockholder of the United Corporation, without the surrender by her of her stock in the United Corporation, so that she then held all the stock of both the United Corporation and the Averill Corporation, which together owned the same property previously owned by the United Corporation. A few days later the Averill Corporation was dissolved and distributed the stock of the Monitor Corporation as a liquidating dividend to Mrs. Gregory, who thereupon sold such stock.

The distribution of the stock of Averill Corporation to Mrs. Gregory was in pursuance of a plan by which part of the assets of the United Mortgage Corporation, consisting of stock of the Monitor Corporation, was segregated in a separate corporation, to wit, Averill Corporation, controlled by Mrs. Gregory. Section 112 (g) of the Revnue Act of 1928 provides:

> "(g) **Distribution of stock on reorganization.**—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

If, then, the transfer of part of the assets of United Mortgage Corporation to the Averill Corporation was a reorganization within the definition of the statute, there was distributed in pursuance of the plan of reorganization to Mrs. Gregory, the sole stockholder of United Mortgage Corporation, a party to the reorganization, stock of Averill Corporation, also a party to the reorganization, without the surrender by Mrs. Gregory of her stock in the United Mortgage Corporation; and therefore no gain to Mrs. Gregory from the receipt of such stock of Averill Corporation was recognizable.

There is no dispute about the validity of this conclusion, assuming the existence of a reorganization. The only issue raised by the opinion of the Circuit Court of Appeals is whether or not there was a reorganization within the definition of the statute.

However, when the Averill Corporation was dissolved and its property, consisting of the Monitor stock, was dis-

tributed in liquidation to Mrs. Gregory as the sole stockholder, she realized a gain under Section 115 (c) of the 1928 Act (Appendix, p. 56), providing "that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock". Such gain, pursuant to Section 111 (a) of the 1928 Act (Appendix, p. 54), was measured by the excess of the then market value of the Monitor stock over the basis to Mrs. Gregory of the stock of Averill Corporation, computed by apportioning her cost for the stock of the United Corporation between the stock of the United Corporation and the stock of Averill Corporation, pursuant to Section 113 (a) (9) of the 1928 Act (Appendix, p. 56). This method of determining her taxable gain was followed by Mrs. Gregory in her return, in accordance with Articles 600 and 625 of Regulations 74 of the Treasury Department.

The Board of Tax Appeals found that Mrs. Gregory had reported all the profit and paid all the tax attributable to the transactions that actually took place. The respondent and the Circuit Court would impose an additional tax in violation of the express provisions of the statute.

II.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the express definition of the statute.

Section 112 (i) (1) (B) of the Revenue Act of 1928 provides:

> "(i) **Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term 'reorganization' means . . . (B)

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred", . . .

Here there was a transfer by United Mortgage Corporation of a part of its assets, consisting of stock of the Monitor Corporation, to another corporation, namely, Averill Corporation, and immediately after the transfer the transferor, that is, United Mortgage Corporation, or its stockholders, comprising Mrs. Gregory, or both, were in control of the corporation, that is, Averill Corporation, to which the assets were transferred. "Control" under Section 112 (j) means the ownership of at least 80 per cent. of the stock of a corporation.

The precise transaction contemplated by the statute, the segregation of part of the assets of a corporation in another corporation, with immediate control of the second corporation in the first corporation or its stockholders, was undertaken and accomplished here. No more complete conformity with the statutory definition could possibly be imagined. No element or factor was lacking: what was accomplished was exactly what the statute said and meant, unless the plainest possible language may be ignored.

It is a cardinal principle that the words of a statute, if plain, are the sole measure of its scope and application. The rule was stated in *Adams Express Company* v. *Kentucky,* 238 U. S. 190, 199, as follows:

> "It is elementary that the first resort, with a view to ascertaining the meaning of a statute, is to the language used. If that is plain there is an end to construction, and the statute is to be taken to mean what it says."

United States v. *Shreveport Grain & Elevator Company,* 287 U. S. 77, 83;
Old Colony R. R. Co. v. *Commissioner,* 284 U. S. 552, 560;
Crooks v. *Harrelson,* 282 U. S. 55, 61;
United States v. *Merriam,* 263 U. S. 179, 187;
Hamilton v. *Rathbone,* 175 U. S. 414, 421;
United States v. *Goldenberg,* 168 U. S. 95, 102.

The following statement by Lord CAIRNS from *Partington* v. *Attorney-General,* L. R. 4 H. L. 100, 122, was approved in *United States* v. *Merriam, supra,* and *Crooks* v. *Harrelson, supra:*

> "I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

That a real danger lurks in departures from the plain language of statutes has repeatedly been emphasized by this Court. The following passage from the opinion in *Pirie* v. *Chicago Title & Trust Co.,* 182 U. S. 438, 451, 452, is peculiarly applicable to the present case:

> "But all legislation is not simple, nor its consequences obvious, or to be controlled, even if obvious. Whether there should be any legislation at all, and

its extent and form, may be matters of dispute. Its consequences may be viewed with favor or with alarm; some regretted, but accepted as inevitable,—accepted as the shadow side of the good. In such situation it is for the legislature to determine, and it is very certain that the judiciary should not refuse to execute that determination from its view of some consequence which (to use the thought and nearly the words of Chief Justice MARSHALL) may have been contemplated and appreciated when the act was passed, and considered as overbalanced by the particular advantages the act was calculated to produce."

Bearing in mind that the reorganization provisions provided for deferring recognition of *losses*, as well as of gains, the following warning in *Van Camp & Sons* v. *American Can Co.*, 278 U. S. 245, 253, is especially significant:

> "The words being clear, they are decisive. There is nothing to construe. To search elsewhere for a meaning either beyond or short of that which they disclose, is to invite the danger, in the one case, of converting what was meant to be open and precise, into a concealed trap for the unsuspecting, or, in the other, of relieving from the grasp of the statute some whom the legislature definitely meant to include."

In *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370, the Court said:

> "And the plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

III.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the intent of Congress.

A. THE INTENT OF CONGRESS TO DEFER RECOGNITION OF GAIN IN FORMAL INTERCORPORATE READJUSTMENTS IS INDICATED BY THE HISTORY OF THE REORGANIZATION PROVISIONS OF THE REVENUE ACTS.

If the intent of Congress needs proof outside the plain language of the statute, it is shown by the history of the definition of reorganization and of collateral provisions of the revenue acts.

As early as 1921 Congress had definitely in mind the advisability of relieving the stagnation in the sale and exchange of capital assets which had resulted from the high surtaxes on capital gains. To encourage *sales* an alternative flat tax of 12½ per cent. was imposed by Section 206 of the Revenue Act of 1921 on the sale of capital assets held for more than two years. The occasion for such a provision was stated in the Report of the Committee on Finance (No. 275, 67th Congress, 1st Session) as follows:

> "Section 206 limits the rate of taxation upon gain derived from the sale of capital assets. Under the present law many sales of farms, mineral properties, and other capital assets have been prevented by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum and the amount of surtax excessively enhanced thereby."

See *Burnet* v. *Hamel*, 287 U. S. 103, 105, 106 (1932); the statement of Chairman Green of the Committee on Ways

and Means in the debate on the Revenue Bill of 1924 (LXV Congressional Record 2428); and the Annual Report of the Secretary of the Treasury for the year ended June 30, 1921, pp. 19, 20.

Similarly, to encourage *exchanges* of capital assets, particularly in connection with intercorporate transactions, the principle was adopted of postponing the imposition of the tax until actual realization of the gain by sale, and meanwhile to withhold recognition of gain so long as the taxpayer's investment in assets held in corporate form was not terminated, but was merely continued in different corporate form. An outline of the development of the exchange and reorganization provisions follows.

In connection with the history of these statutory provisions it will be recalled that Mrs. Gregory, previously the owner of the stock of one corporation, through intercorporate transactions became the owner of the stock of two corporations, which together owned the same assets previously owned by the one corporation, thus continuing her investment except for a change in form, and that thereafter she derived a gain from the dissolution of one corporation and the sale of its property, thereby terminating her investment *pro tanto*. The desirability of the ultimate sale in question was enhanced by the ameliorating effect of the reorganization and capital gain provisions of the statute, which were intended to accelerate just such a transaction.

Revenue Acts of 1913, 1916, 1917, 1918 and 1921. The Acts of 1913, 1916 and 1917 contained no specific provisions with respect to exchanges of property, whether or not in connection with intercorporate transactions, and consequently no definition of reorganization. The Act of 1918 in Section 202 (b) for the first time expressly prescribed the treatment of exchanges of property, and excepted from

the recognition of gain or loss the exchange of stock or securities for new stock or securities of no greater aggregate par or face value in connection with the "reorganization, merger, or consolidation of a corporation," leaving the meaning of "reorganization" to be gathered from the context or from ordinary usage. The Act of 1921 incorporated in Section 202 enlarged and more specific exchange and reorganization provisions, worked out from a draft submitted by the Treasury Department (Hearings before Committee on Ways and Means, July 26-29, 1921, p. 406), including in subdivision (c) (2) a definition of "reorganization" like that in Section 112 (i) (1) of the Revenue Act of 1928, exclusive of clause (B), which is involved here. (See Appendix, p. 55.) In the Report of the Committee on Finance of the Senate on the Revenue Bill of 1921 (No. 275, 67th Congress, 1st Session), it was said:

> "Section 202 (subdivision c) provides new rules for those exchanges or 'trades' in which, although a technical 'gain' may be realized under the present law, the taxpayer actually realizes no cash profit."

Revenue Act of 1924. Prior to the introduction in Congress of the Revenue Bill of 1924 the Treasury Department gave extensive consideration to the revision of the reorganization provisions of the 1921 Act, and adopted the policy of prescribing in the statute comprehensive and precise provisions to cover every possible situation. Among other things, it contemplated extending the definition of "reorganization" to include "a division of all or a part of the assets of one corporation into one or more corporations", but this language, being regarded as insufficiently specific, was replaced in the draft of bill submitted by the Treasury Department to the Committee on Ways and Means

(Committee Print No. 1, December 17, 1923) by the more exact provision which has come to be known as clause (B) of the definition. This new clause defined "reorganization" to mean:

> "(B) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred."

The definition of reorganization so amplified was accepted by Congress and enacted without change in the Revenue Act of 1924 (Section 203 (h) (1)), and has continued without change in the Revenue Acts of 1926 (Section 203 (h) (1)), 1928 and 1932 (Section 112 (i) (1)) and, so far as clause (B) (relettered clause (C)) is concerned, in the Revenue Act of 1934 (Section 112 (g) (1)).

During the consideration of the Revenue Bill of 1924 by the Ways and Means Committee it released a statement prepared by Special Assistant to the Secretary of the Treasury Gregg with reference to the changes from the 1921 Act proposed by the Department, and adopted by Congress, containing detailed explanations of the painstakingly formulated provisions of Sections 203 and 204 relating to recognition of gain or loss from sales or exchanges and to the basis for determining gain or loss. (See Appendix C to Miller, "Reorganizations and Other Exchanges in Income Taxation".) These explanations were largely repeated in the Report on the bill of the Committee on Ways and Means (No. 179, 68th Congress, 1st Session) and in the Report of the Committee on Finance (No. 398, 68th Congress, 1st Session).

Generally with respect to Section 203 the Reports of

the House and Senate Committees (following the Gregg statement) said (italics ours):

> "The existing law provides, in section 202 (*c*), that no gain or loss is recognized (that is, considered for the purpose of determining taxable income) from an exchange of property unless the property received in exchange has a readily realizable market value.
>
> The provision is so indefinite that it cannot be applied with accuracy, nor with consistency. It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchanges in which it is not desired to tax the gain or allow the loss. *This results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.*"

As a reason for modifying the provision (Section 202 (*c*) (1) of the 1921 Act) relating to the exchange of property held for investment or for productive use, the Report of the Senate Committee (following the Gregg statement) said (italics ours):

> "In the bill the language is changed to provide that the property held for investment or for productive use must be exchanged for a like kind of property. If the property received is of a like kind, it is immaterial whether it is to be held for investment or for productive use. *The intention of the party at the time of the exchange is difficult to determine, is subject to change by him, and does not represent a fair basis of determining tax liability.*"

As to another specific paragraph (corresponding to Section 112 (b) (4) of the Revenue Act of 1928, Appendix, p. 54), the Report of the House Committee (similarly to the Re-

port of the Senate Committee and the Gregg statement) said (italics ours):

> "Paragraph (3) provides that no gain or loss is recognized if a corporation, a party to a reorganization, exchanges property for stock or securities in another corporation, a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. *The statute should contain a definite rule on this question.*
>
> Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented on account of the provisions of the tax law. If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation."

Commenting on the provision in Section 203 (c) of the 1924 Act for permitting the distribution without tax of stock of a party to a reorganization (corresponding to Section 112 (g) of the Revenue Act of 1928, Appendix, p. 54), which has appeared without change in the Acts of 1926, 1928 and 1932, but was omitted in the Act of 1934, the Report of the Senate Committee (following the Report of the House Committee and the Gregg statement) said:

> "Section 203 (c): There is no provision of the existing law which corresponds to subdivision (c). Under the existing law, if Corporation A organizes a subsidiary, Corporation B, to which it transfers part of its assets in exchange for all the stock of Corporation B, and then distributes the stock of Corporation B as a dividend to its stockholders without the surrender by the stockholders of any of their stock, then

such a dividend is a taxable one. If, however, Corporation A organizes two new corporations, Corporations B and C, and transfers part of its assets to Corporation B and part to Corporation C, and the stockholders of Corporation A surrender their stock and receive in exchange therefor stock of Corporations B and C, no gain from the transaction is recognized. Thus, under the existing law, the same result, except as to tax liability, may be obtained by either of two methods; but if the first method set out above is adopted, the gain is taxable while if the second method set out above is adopted, there is no taxable gain. Subdivision (c) of the bill permits the reorganization to be accomplished in the first manner set out above without the recognition of gain. The first method set out above represents a common type of reorganization and clearly should be included within the reorganization provisions of the statute."

As to the insertion in the definition of reorganization of clause (B) (corresponding to Section 112 (i) (1) (B) of the Revenue Act of 1928, Appendix, p. 55), the Reports of the House and Senate Committees (following the Gregg statement) said:

"Section 203 (h)-(1): Subdivision (h) (1) contains a definition of reorganization which corresponds to the definition contained in section 202 (c) (2) of the existing law. *The only change in the definition is to include within its terms the case of a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders, or both, are in control of the corporation to which the assets are transferred.* This is a common type of reorganization and clearly should be included within the reorganization provisions of the statute."

Generally with respect to Section 204, relating to the basis for ascertaining gain or loss, the Reports of the House and Senate Committees (following the Gregg statement) said (italics ours):

> "The general theory of this section is that where no gain or loss is recognized as resulting from an exchange, the new property received shall for purposes of determining gain or loss from a subsequent sale, and for depreciation and depletion, be considered as taking the place of the old property given up in connection with the exchange. The provisions of section 203 of the bill that no gain or loss is recognized from certain exchanges, do not grant an exemption and are not so intended. These provisions are based upon the theory that the types of exchanges specified in section 203 are merely changes in form and not in substance, and consequently should not be considered as effecting a realization of income at the time of the exchange. *In other words, these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale.* It follows, therefore, that in the case of such an exchange, the property received should be considered as taking the place of the property exchanged."

As an example of the computation of the base in the case of distributions in connection with a reorganization (see Section 113 (a) (9) of the Revenue Act of 1928, Appendix, p. 56), the Reports of the House and Senate Committees (following the Gregg statement) said:

> "Example A: A purchased a share of stock in corporation X for $100. Corporation X organizes a subsidiary, corporation Y, to which it transfers a part of its property in exchange for all of the stock of corporation Y. It then distributes the stock of corporation Y, share for share, to its stockholders as a dividend.

Under the provisions of subdivision (c) of section 203 of the bill, A realizes no income from the receipt of this stock.

The basis of the share of stock in corporation X, $100, shall, under this paragraph, be apportioned between the share of stock in corporation X and the share of stock in corporation Y. If at the time of the distribution of the share of stock in corporation Y, the stock of the two corporations is of the same market value, then one-half of the basis of the old stock, $50, shall be apportioned to each share. Gain or loss from the subsequent sale of either share of stock shall be determined by comparing the sale price with $50, the basis of the share sold."

Revenue Acts of 1926 and 1928. No changes from the Revenue Act of 1924 were made in the reorganization provisions in the Revenue Acts of 1926 and 1928. Section 203 of the 1924 and 1926 Acts became Section 112 of the 1928 Act, with subdivisions (c), (g) and (h) of the former Acts relettered as subdivisions (g), (h) and (i) of the later Act.

Revenue Act of 1932. The only changes in Section 112 of the Act of 1928 made in the Act of 1932 were the addition of a new subdivision (k), relating to transfers to foreign corporations, and the insertion in another subdivision of a clause made necessary by such addition, neither change affecting the definition of reorganization.

Revenue Act of 1934. Although prior to the introduction of the Revenue Bill of 1934 a sub-committee of the Committee on Ways and Means had recommended the abolition of the reorganization provisions, and the Treasury Department had advocated their complete redrafting so as to express them simply and generally, the bill as enacted into law retained intact the definition of reorganization in clause (B), while slightly modifying the definition

in clause (A), with which we are not concerned. (See Section 112 (g) of the Revenue Act of 1934.) The provision permitting the tax-free distribution of stock of a corporation a party to a reorganization, without surrender of the old stock (Section 112 (g) of the Revenue Act of 1928, Appendix, p. 54), was omitted from the 1934 Act.

To summarize, clause (B) of the definition of reorganization has appeared without change in the Acts of 1924, 1926, 1928, 1932 and (relettered clause (C)) 1934. It was retained in the 1934 Act on the "broad principle", as newly expressed by the Committee on Ways and Means, "that no taxable profit is realized from a reorganization, if no money passes and if the changes in corporate organization are essentially changes only in form." However, the provision of the 1924, 1926, 1928 and 1932 Acts for the tax-free distribution, without the surrender of the old stock, of stock in a corporation a party to a reorganization, was repealed, as permitting tax avoidance. (See Report of Committee on Ways and Means (No. 704, 73rd Congress, 2d Session) on Revenue Bill of 1934). Under the 1934 Act, therefore, the transfer from the United Corporation to Averill Corporation would still constitute a reorganization within the language of the statute, but the distribution of the Averill stock would no longer be without tax.

B. CONGRESS DID NOT INTEND THAT REORGANIZATIONS BE JUDGED BY THE MOTIVES INDUCING THEM.

The Circuit Court in its opinion maintains that, even though a readjustment conformed with the express provisions of the definition of reorganization, and even though "the collective interests still remained in solution", nevertheless the readjustment would not be a reorganization un-

less undertaken "for reasons germane to the conduct of the venture in hand", and that the reduction of the stockholders' taxes and the consequent increase in the net profit on the sale of an investment was not a reason germane to the conduct of the venture in hand or an ordinary business purpose. Neither proposition finds any support in the revealed intent of Congress or in common commercial concepts.

The Circuit Court attempts to support its construction of clause (B) of the definition of reorganization by stating that it accords with the history of the section. It is said that clause (B) was intended as supplementary to the provision permitting the tax-free distribution, in connection with a reorganization, of stock of a party to a reorganization, without surrender of the stockholders' old stock, and that in the House Report and the Senate Report on the 1924 bill the purpose was stated to be to exempt "from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented." The first proposition is at least doubtful, as will have been observed from the historical outline above, particularly as the provision which clause (B) was intended to supplement, according to the Circuit Court, has been eliminated from the 1934 Act, although clause (B) is retained. As to the second proposition, the paragraph from which the phrase was quoted, as set forth above (p. 19), refers to earlier statutes and appears, not in connection with the explanation of the insertion of clause (B), but in connection with another new provision of the 1924 Act. More pertinent are the statements from the Gregg and the Committee reports quoted above (p. 18) that the specific exception from tax of certain cases of exchanges "results in definiteness and accuracy and enables a tax-

payer to determine prior to the consummation of a given transaction the tax liability that will result therefrom", and that "the intention of the party at the time of the exchange is difficult to determine, is subject to change by him, and does not present a fair basis of determining tax liability."

A fundamental fallacy of the decision below appears to lie in the Circuit Court's confusion of intent and motive and in the disregard of intent in an attempt to make motive control the construction of the statute. The *motive* of Congress in enacting the reorganization provisions was doubtless to facilitate ordinary business transactions, as well as, among other things, to collect more taxes in the long run, and to enable both taxpayers and the Treasury Department definitely to determine in advance whether any corporate readjustment would result in taxable gain. The *general intent* of Congress was to postpone recognition of gain or loss so long as a taxpayer's investment was in essence continued, although in different corporate form. Its *specific intent* was to postpone recognition of gain or loss upon exchanges or distributions in connection with a "reorganization", which as expressly defined in clause (B) comprised a transfer by a corporation of assets to another corporation if immediately after the transfer the transferor or its stockholders owned 80 per cent. of the stock of the transferee corporation.

Concretely, the intent of Congress was to stamp as a "reorganization", for the purposes of the reorganization provisions, a transaction by which corporation X transferred asset M to corporation Y in exchange for 80 per cent. or more of the stock of corporation Y (or less if corporation X or its stockholders already owned stock of corporation Y). X would continue its interest in the asset

M through its control of the stock of Y corporation, or, if the stock of Y were distributed to the stockholders of X, they would hold the stock of both corporations together having the same assets as the former single corporation. It may be that the motive for such a transaction was to incorporate a branch of X in another State, for business convenience or to reduce State taxes; or to effect a segregation, required by law, of part of the assets of X; or to permit the subsequent acquisition by third persons of an interest in Y corporation and its assets through an additional issue of its stock, or the sale of stock already issued. What of it, so long as the transaction described in the statute took place and *immediately* thereafter the transferor corporation or its stockholders had the required control of the transferee corporation?

In the present case corporation X transferred asset M to corporation Y in exchange for all the stock of Y, which was distributed to the sole stockholder of X. She then owned all the stock of both corporations, which together had the same assets as the former single corporation,—precisely the situation intended by the statute. Her investment was not terminated by the segregation, but continued in different corporate form. If because Mrs. Gregory preferred two stock certificates instead of one, or if for any other reason, frivolous or otherwise, she had brought about this segregation and had continued indefinitely to hold the stock of Y, it is hard to believe that the reorganization would have been questioned.

Clearly, the controversy arose because *after* the statute had been satisfied she caused the dissolution of Y corporation and terminated her investment to that extent. Yet the view of the Circuit Court, as expressed in its opinion, seems to be that the dissolution of the Averill Corpo-

ration, following the corporate readjustment, was material only as evidence of the purpose or motive in consummating the various transactions, in other words, as evidence that the reasons for undertaking the readjustments were not germane to the conduct of the venture in hand. If this conception be correct, then, if there was no reorganization on the facts as they existed, there would equally have been no reorganization if just prior to the dissolution of the Averill Corporation Mrs. Gregory had changed her mind and continued to hold its stock. The difficulties in applying such a criterion based on motives and reasons are sufficiently patent.

It can scarcely be, on the other hand, that the Court regarded the dissolution of the Averill Corporation, not as evidence of motives, but as a transaction altering the effect of the transactions which had previously taken place, for the definition of reorganization emphasizes the necessity for control only "immediately after the transfer" and obviously contemplates a possible sale or other disposition of the stock of the controlled corporation at any time thereafter. A condition subsequent that there should be no early sale or other action terminating control cannot possibly be read into the statute. Even the Circuit Court's view of a condition precedent based on motives is more logical than this construction. In fact, in 1924, when clause (B) of the definition was first enacted, Congress was well aware, and adopted the broadened reorganization provisions having in mind, that there were a number of pending proceedings for the division of corporate properties, such as the segregation of coal properties from railroads, in which the courts required the early sale of the stock of corporations formed to take over such segregated properties. (See *United States* v. *Lehigh Valley R. R.*

Co., 254 U. S. 255, and Poor's Manual of Railroads for 1924, at page 347; G. C. M. 2177, VI-2 C. B. 112. See also p. 49 below.)

The Circuit Court in the present case, after recognizing that corporate readjustments were not to be considered as "realizing" any profit, where "the collective interests still remained in solution", gave as its *ratio decidendi*:

> "But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution."

Such presupposition seems far from plain, if the investment is not terminated by the reorganization, but continues, however briefly, in different corporate form. Nothing appears in the statute or in the intent of Congress, repeatedly expressed as set out above, to reveal the existence of such a presupposition or to warrant giving it controlling effect over the language of the statute. The Circuit Court's decision is based entirely on the assumption that such a presupposition exists and not only underlies, but overrides, the statute.

Every reference to the reorganization provisions in the reports of the Committees of Congress makes it clear that the intent of Congress was to postpone recognition of taxable gain so long as there were merely formal corporate readjustments and until there was an actual realization of a cash profit or its equivalent. In the present case the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to Mrs. Gregory were formal readjustments recognized by Congress in the statute as involving the realization of no taxable gain, and it was not until the dissolution of the Averill Corporation and the distribution by it of the Monitor stock that

the equivalent of a cash profit was realized. At that point, and not until that point, Mrs. Gregory's gain was subject to tax in accordance with the definite provisions of the statute and the equally definite intent of Congress. The tax on such gain computed in exact conformity with the statute and regulations has been paid.

C. NEVERTHELESS THE DISPOSITION OF INVESTMENTS WITH THE GREATEST ULTIMATE PROFIT IS A REASON GERMANE TO THE CONDUCT OF BUSINESS.

But the Circuit Court further assumes that the motive of minimizing taxes is not a reason germane to the conduct of the venture in hand. If it were, the Court's conclusion would evidently be different.

It will be recalled that there was a market for the Monitor stock held by the United Corporation which was favorable to its sale if the expenses and burdens of sale were not excessive, in other words, if the net profit were worth while. If the United Corporation sold the Monitor stock and distributed the proceeds to Mrs. Gregory, there would be income taxes on both corporation and stockholder; if the United Corporation distributed the Monitor stock to Mrs. Gregory and she sold it, she would be taxable at surtax rates on its full value as upon an ordinary dividend; if the Monitor stock were transferred in exchange for stock of the Averill Corporation, which was distributed to Mrs. Gregory, and then she received the Monitor stock in complete liquidation of the Averill Corporation, she would be taxable as upon a sale of the stock of the Averill Corporation. On this last basis the net avails to the ultimate stockholder were sufficient to warrant the transaction, and the reorganization was consummated with the ordinary business motive, actuating most corporations, of making or saving the most net profit for the stockholders.

In the case of an investment company the disposition of investments most advantageously to its stockholders seems quite germane to the venture. As said by Mr. R. N. Miller in "Corporate Reorganizations: The Present Situation", published in the Tax Magazine for September, 1934 (Vol. XII, No. 9):

> "Tax problems are certainly 'germane' in the sale or exchange of assets when the rates are high. The money which is paid to the Government because of a tax levy is gone just as truly and finally as if it is paid out for expenses; the practical question in any sale or any exchange is how much the seller will have left of his capital after all the consequences have been met, and this figure is lessened by an increase in the amount of taxes just as much as it is by a decrease in the amount of selling price or value of property received."

It may be wondered what the Circuit Court would have decided in the case of a New York corporation doing business throughout the United States, which transferred its California property in exchange for the stock of a California corporation, with the motive of avoiding the stockholders' liability for corporate debts, including taxes, until recently imposed by California law. Obviously such readjustment would not have been consummated for the benefit of the New York corporation itself, but to relieve its stockholders of liability. Would it be regarded as not undertaken for reasons germane to the conduct of the venture in hand?

D. When Congress has intended the purpose of a transaction to control it has expressly so provided.

The Circuit Court also points out, to support its conclusion, that "the act itself gives evidence that, on occasion anyway, the purpose of a transaction should be the guide",

referring to Section 115 (g) and Section 112 (c) (2) of the 1928 Act, relating to distributions in specified circumstances which have the effect of a taxable dividend. The Court seems to have answered its own argument by showing that, where Congress has intended the purpose or effect of a transaction to be controlling, it has been able to say so in express language, without compelling recourse to surmises and assumptions. Thus, also, in Section 112 (k) of the Revenue Act of 1932, enacted in order to restrict the growing use of foreign corporations in connection with reorganizations, Congress prescribed that a foreign corporation should not be considered a corporation unless it had been established to the satisfaction of the Commissioner that any exchange or distribution was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.

Although, as shown by the foregoing history of the reorganization provisions, a policy of liberalization prevailed until recently, nevertheless, where there appeared to be defects in the provisions of the statute, Congress corrected them without relying on judicial legislation. In Section 204 (a) (7) of the 1924 and 1926 Acts, relating to the basis for determining gain or loss, it was provided that the basis for property "(other than stock or securities in a corporation a party to the reorganization)" acquired by a corporation in connection with a reorganization should be the same as it would be in the hands of the transferor. In order to avoid the limitation on the basis for property to its cost to its former owner, many reorganizations were planned in such a way that the property acquired was "stock or securities in a corporation a party to the reorganization", thereby taking advantage of the exception embodied in the parenthetical clause. This method of tax avoidance was sustained, even though it was contended

that Congress did not intend the result which could be accomplished under it. (G. C. M. 7285, IX-1 C. B. 181 (1930)) In Section 113 (a) (7) of the 1928 Act the provision in question was amended to eliminate the parenthetical clause, but without any attempt to make such modification retroactive. Again, with respect to the same provision, which in the 1928 and prior Acts required an 80 per cent. control to be operative, Congress modified it in Section 113 (a) (7) of the 1932 Act to require only a 50 per cent. control. In the 1934 Act, as we have seen, Congress omitted Section 112 (g) of the 1928 and prior Acts on the ground that it permitted tax avoidance.

But clause (B) of the definition of reorganization still stands without modification as it has since 1924. Every examination of the intent of Congress must lead to the conclusion that its lucid language requires no interpreter and does not need or permit such an appendage as, "provided the readjustment was undertaken for reasons germane to the conduct of the venture in hand". In "Statutory Interpretation", 43 Harvard Law Review 863, Mr. Max Radin said (p. 866):

> "Words are certainly not crystals, as Mr. Justice Holmes has wisely and properly warned us, but they are after all not portmanteaus. We can not quite put anything we like into them. And we may not disregard them in statutes."

It appears, therefore, that the intent of Congress in enacting clause (B) of the definition of reorganization was to defer recognition of gain or loss so long as the changes in corporate organization were essentially changes only in form, regardless of the motives for them, and until the gain or loss should be realized by a sale; that in any event the attainment of the greatest possible net profit for stock-

holders is a reason germane to the conduct of the venture in hand and a motive which properly may and does actuate ordinary business transactions; and, finally, that when Congress desired taxpayers' motives or the effect of a transaction to affect their tax liability it has said so in no uncertain terms, finding no difficulty in amending the statute whenever the occasion warranted it. In short, not only is clause (B) definite and precise in its language and ordinary meaning, but no actual or constructive intent of Congress can be discovered or inferred which might create any ambiguity.

IV.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the regulations and rulings of the Treasury Department.

The regulations of the Treasury Department have always construed the reorganization provisions of the statute to mean what they said.

As to the definition of reorganization in Section 112 (i) (1) of the 1928 Act (Appendix, p. 55), Regulations 74 of the Department prescribed in Article 577 (italics ours):

> ART. 577. **Definitions.**—The term "reorganization", as used in sections 112, 113 and 115 means—
>
> (1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) *A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,*

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent. of the voting stock, and

(2) At least 80 per cent. of the total number of shares of all other classes of stock of the corporation. . . .

This regulation in the same form was first promulgated as Article 1577 of Regulations 65 under the 1924 Act and also appeared without change as Article 1577 of Regulations 69 under the 1926 Act and Article 577 of Regulations 77 under the 1932 Act.

As to exchanges and distributions in connection with a reorganization under Section 112 of the 1928 Act (Appendix, p. 54), Regulations 74 prescribed in Articles 574 and 576 (italics ours):

ART. 574. **Exchanges in connection with corporate reorganization.**—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reor-

ganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. If two or more corporations reorganize, for example, by—

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or

(4) *The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation*—

then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.) . . .

ART. 576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

Article 576 first appeared as Article 1576 of Regulations 65 under the 1924 Act and was repeated without change as Article 1576 of Regulations 69 under the 1926 Act and Article 576 of Regulations 77 under the 1932 Act. Article 574 appeared without change as Article 574 of Regulations 77 under the 1932 Act, and is substantially similar to the corresponding portions of Article 1574 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act.

As to the source of the distribution of stock in a reorganization, provided for in Section 112 (h) of the 1928 Act (Appendix, p. 55), see Article 578 of Regulations 74 (similar to Article 1578 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act and to Article 578 of Regulations 77 under the 1932 Act); and as to the basis for ascertaining gain or loss on the sale of property acquired in a reorganization, whether by a corporation or its stockholders, as provided for in Section 113 (a) (7) and (9) of the 1928 Act (Appendix, p. 56), see Articles 598 and 600 of Regulations 74 (similar to Articles 1598 and 1600 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act and to Articles 598 and 600 of Regulations 77 under the 1932 Act).

As no regulations have yet been promulgated under the 1934 Act, this completes the review of pertinent regulations issued since the enactment in the Revenue Act of 1924 of clause (B) of the definition of reorganization (see

Point III above), with which, as Section 112 (i) (1) (B) of the 1928 Act (Appendix, p. 55), we are here concerned.

It is significant that the statement of the definition of reorganization in clause (B) contained in the regulations above quoted is entirely unqualified, just as is the language in the successive statutes. Certainly, if the Treasury Department had had any intention of trying to write into the statutory definition any qualification or condition, as the Court below has attempted to do in this case, such intention would have been expressed in some of these regulations.

With respect to rulings of the Treasury Department less formal than regulations, they are few so far as they bear on the proper interpretation of clause (B) of the definition of reorganization, because it was too clearly expressed to require construction. Never, to the knowledge of counsel, has the Department ruled, prior to the decision of the Circuit Court in this case, that a transfer by a corporation of a part of its assets to another corporation in exchange for all its stock was not a reorganization within any of the Revenue Acts from 1924 to 1934.

Indeed, in S. M. 4911, V-1 C. B. 250 (1926), the Solicitor of Internal Revenue ruled:

> "The Department has consistently given effect to the doctrine of separate corporate entity, regardless of consequences, wherever corporate organizations are availed of in good faith and within the law, even as to cases wherein the corporate organization or transaction is admittedly undertaken solely for the purpose of avoiding tax liability."

See also L. O. 1062, 4 C. B. 168, 171; G. C. M. 3008, VII-1 C. B. 235.

In I. T. 2542, IX-2 C. B. 126 (1930), the M Company for a minority issue of its stock acquired a minority stock interest in the N Company, without recognition of gain to the transferor stockholders of the N Company, *by interposing a new corporation, the O Company,* which acquired the N minority stock for all its stock and then transferred the N stock, comprising all its assets, in exchange for M stock, thereupon dissolving and distributing the M stock to its stockholders, the former holders of N stock, upon their surrender of their O stock. These transactions, being in conformity with the statute, were recognized to constitute a reorganization under clause (A) of the definition of reorganization, although the O Company was organized and quickly dissolved solely for tax avoidance purposes.

In G. C. M. 2177, VI-2 C. B. 112, 114 (1927), involving the segregation of coal properties of the Reading Company in a new corporation, the Treasury Department ruled:

> "The fact that at some later date to be determined by the court one of the two holdings was required to be disposed of does not change the fact that immediately after the transfer the M Company, or its stockholders, or both, were in control of the R Company, within the meaning of section 203 (i) of the 1924 Act. . . ."

In *Evans Products Company* v. *Commissioner,* 29 B. T. A. 992 (1933), A, who owned all the stock of X, agreed to sell a 51 per cent. interest therein to B. To escape income tax A organized corporations Y and Z and exchanged his stock in X for the stock of Y, which thereupon exchanged the stock of X for the stock of Z, and Z thereupon liquidated X. Then Y sold to B 51 per cent. of the stock of Z. All these transactions took place within three

days. Nevertheless, the Commissioner conceded that there was a reorganization.

In general, so far as is revealed by published rulings of the Treasury Department, it has never departed from the position that the question whether or not a reorganization existed under a particular state of facts must be determined from the language of the statute and without reference to the purposes or motives of those who carried out the transactions.

I. T. 2259, V-1 C. B. 18 (1926);
G. C. M. 1345, VI-1 C. B. 15 (1927);
G. C. M. 1753, VI-1 C. B. 138 (1927);
I. T. 2530, IX-1 C. B. 194 (1930).

In G. C. M. 7285, IX-1 C. B. 181 (1930), full effect was given to the parenthetical clause in Section 204 (a) (7) and (8) of the Revenue Acts of 1924 and 1926, which permitted a stepped-up basis if the property acquired in a reorganization was stock or securities in a corporation a party to a reorganization. Although, until this clause was eliminated in Section 113 (a) (7) and (8) of the Revenue Act of 1928, it was extensively exploited in formulating reorganization plans, the General Counsel of the Internal Revenue Bureau ruled (p. 184):

> "It has been suggested, because the exceptions contained in section 204 (a) 7 and 8 have been omitted, so far as the transactions herein discussed are involved, from the corresponding section of the Revenue Act of 1928, that the provisions of the Revenue Act of 1928 may properly be taken as interpretative of the Revenue Act of 1926. With this contention this office does not agree. The corresponding section of the Revenue Act of 1928 (section 113) was not made retroactive, and there is nothing in the statute to indicate that Congress intended that the section should

be given retroactive application in any particular. The provisions of the Revenue Act of 1926, above quoted, are clear and unambiguous. In the absence of ambiguity in the statutes, the courts will not look beyond the language of the statute itself. As stated in 25 Ruling Case Law, page 962:

> '. . . When the language of the statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction; the statute must be given its plain and obvious meaning. This principle is to be adhered to notwithstanding the fact that the court may be convinced by extraneous circumstances that the legislature intended to enact something very different from that which it did enact.'

To the same effect, see also *Lake County* v. *Rollins* (130 U. S., 662); *United States* v. *Merriam* (263 U. S. 179 (T. D. 3535, C. B. II-2, 87)); *Penn Mutual Life Insurance Co.* v. *Lederer* (252 U. S., 523 (T. D. 3046, C. B. 3,249)); *New York Telephone Co.* v. *Treat* (130 Fed., 340, certiorari denied 198 U. S., 584); and Lewis' Sutherland Statutory Construction, section 363."

It is noteworthy that Miller on "Reorganizations and Other Exchanges in Federal Income Taxation", a standard work, which was cited by the Board in its opinion, contains no suggestion that the validity of a transaction within the reorganization provisions of the statute might be impaired by a motive of tax avoidance or by reasons not "germane to the conduct of the venture in hand". If any of the rulings or decisions had shown any support for construction of the statute based on motives, the author would have been obliged to discuss that subject. In 1931, when this book was published (some three years after the transactions here at issue), no one in or out of the Treasury Department

supposed that the language of the definition of reorganization could be affected or distorted by the taxpayer's motives, although clause (B) had been in effect since 1924, and clause (A) since 1921.

The manner of reporting her income and of computing the tax thereon employed by Mrs. Gregory in her return, and confirmed by the Board of Tax Appeals herein, was strictly in conformity with all regulations and rulings of the Treasury Department. The position adopted by the Circuit Court of Appeals in its opinion has never at any time been advanced by the Treasury Department in its regulations or rulings.

In *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, the Court said with respect to pertinent articles of Regulations 45 of the Treasury Department, relating to the income tax under the 1918 Act (p. 378):

> "The regulations were made pursuant to express authority (see § 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. *United States* v. *Grimaud,* 220 U. S. 506, 517, 518, 55 L. ed. 563, 567, 568, 31 S. Ct. 480; *International R. Co.* v. *Davidson,* 257 U. S. 506, 514, 66 L. ed. 341, 346, 42 S. Ct. 179. They constitute contemporaneous construction by those charged with the administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons. *United States* v. *Moore,* 95 U. S. 760, 763, 24 L. ed. 588, 589; *Brewster* v. *Gage,* 280 U. S. 327, 336, 74 L. ed. 457, 462, 50 S. Ct. 115."

The regulations promulgated by the Treasury Department under the 1924 Act, the 1926 Act, and the 1932 Act, as well as under the 1928 Act, with no informal rulings not in conformity therewith, consistently recognized as a "reorganization" the transfer by a corporation of a part of

its assets to another corporation in exchange for all of its stock, with no suggestion of condition precedent or subsequent derived from the motives inducing the transaction or otherwise. The executive interpretation thus placed upon the definition of reorganization must, in view of the repeated reenactment of the statute without change, be deemed to have received implied legislative recognition and approval. Congress is presumed to have legislated with knowledge of an established usage of an executive department of the Government.

National Lead Company v. *United States*, 252 U. S. 140, 146;

Wisconsin v. *Illinois*, 278 U. S. 367, 413;

United States v. *Kirby Lumber Co.*, 284 U. S. 1, 3;

Old Colony R. R. Co. v. *Commissioner*, 284 U. S. 552, 557;

Massachusetts Mutual Life Insurance Co. v. *United States*, 288 U. S. 269, 273.

V.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the decisions of the Courts.

In the present case the Board of Tax Appeals and the Circuit Court of Appeals agreed that the motive to minimize taxes did not vitiate a transaction or warrant disregard of the corporate entity. The Board said (R. 10):

> "The purpose to reduce taxes does not control the recognition of the corporation, *Bullen* v. *Wisconsin*, 240 U. S. 625, nor does the extent of its legitimate

function or operations. Its existence can not be denied to escape liability, *Nowland Realty Co.* v. *Commissioner,* 47 Fed. (2d) 1018; *People* v. *Williams,* 198 N. Y. 54; 91 N. E. 266; *112 West 59th Street Corp.,* 23 B. T. A. 767, and with equal force it may enjoy its corporate benefits. That the petitioner was its sole shareholder does not serve to obscure its identity, *Planters Cotton Oil Co., Inc.* v. *Hopkins,* 286 U. S. 332, else the United Corporation would likewise be obliterated, and this is not suggested. The shortness of its life does not indicate less than a complete entity while it lived. *Regal Shoe Co.,* 1 B. T. A. 896."

The Circuit Court said (R. 35, 37):

"We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. *U. S.* v. *Isham,* 17 Wall. 496, 506; 21 L. Ed. 728; *Bullen* v. *Wisconsin,* 240 U. S. 625, 630, 36 S. Ct. 473, 60 L. Ed. 830. . . .

. . . we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, . . ."

This Court in recent tax cases has had occasion to consider urgent demands for the disregard of corporate

entities and in every instance has sustained their full recognition.

New Colonial Ice Co., Inc. v. *Helvering,* 292 U. S. 435;

Burnet v. *Commonwealth Improvement Company,* 287 U. S. 415;

Burnet v. *Clark,* 287 U. S. 410;

Dalton v. *Bowers,* 287 U. S. 404;

Planters Cotton Oil Co. v. *Hopkins,* 286 U. S. 332;

Klein v. *Board of Supervisors,* 282 U. S. 19.

It has also often been held that a purpose to minimize or avoid taxes is immaterial.

Superior Oil Company v. *United States,* 280 U. S. 390;

Bullen v. *Wisconsin,* 240 U. S. 625;

Jones v. *Helvering,* 71 Fed. (2d) 214, certiorari denied October 8, 1934.

In *United States* v. *Phellis,* 257 U. S. 156, the Court said, referring to reorganizations (p. 172):

> "In such matters, what was done, rather than the design and purpose of the participants, should be the test."

United States v. *Isham,* 84 U. S. 496, involving stamp taxes on instruments, has always been considered a controlling authority. The Court answered a contention of the Government as follows:

> "It is said that the transaction proved upon the trial in this case, is a device to avoid the payment of a stamp duty, and that its operation is that of a fraud upon the revenue. This may be true, and if not true

in fact in this case, it may well be true in other instances. To this objection there are two answers:

1. That if the device is carried out by the means of legal forms, it is subject to no legal censure. . . .

Another answer may be given to the objection more comprehensive in its character. It is this: that the adoption of a rule that the form of the instrument can be disregarded, and its real character be investigated for the purpose of determining the stamp duty, would produce difficulties and inconveniences vastly more injurious than that complained of."

Evidently, therefore, the decision of the Circuit Court was purely a matter of construction of the statute. As it said (R. 35), "the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes". But the Court's decision strikes a dissonant note, which is out of harmony with the language of the definition of reorganization (as seen under Point II), with the intent of Congress (as seen under Point III), and with the consistent regulations of the Treasury Department (as seen under Point IV).

The Circuit Court cites no direct authority for its position. It suggests comparison (R. 36) with *Lonsdale* v. *Commissioner,* 32 Fed. (2d) 537 (C. C. A., 8 Circ., April 18, 1933), in which the Court held that clause (B), pursuant to its terms, "required a transfer by a corporation", and not by third parties, and refused to ignore corporate entities, and *Prairie Oil & Gas Co.* v. *Motter,* 66 Fed. (2d) 309 (C. C. A., 10 Circ., July 13, 1933), in which, one corporation having purchased the properties or the stock of another corporation for cash, the Court held that there was no reorganization within clause (A). It regards as pertinent this Court's decision in *Pinellas Ice &*

Cold Storage Co. v. *Commissioner,* 287 U. S. 462, and its own decision in *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937, saying with respect to the construction of clause (A) of the definition of reorganization by the decisions in those cases (R. 36):

> "The violence done the literal interpretation of the words is no less than what we do here."

In *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937 (C. C. A., 2 Circ., July 29, 1932), the Cortland Company in 1925 transferred substantially all of its properties to the Deyo Company in exchange for $76,874 in cash and $159,750 in six promissory notes of the latter Company, falling due over a period of fourteen months, and thereupon distributed such cash and notes to its stockholders and proceeded to dissolve. The Court held (1) that, even if there were a reorganization within clause (A) of the definition of reorganization, the exchange was taxable because short-term promissory notes were not "securities" within the meaning of Section 203 (b) (3) and (e) of the 1926 Act, and (2) that there was not a reorganization because there was no continuity of interest on the part of the transferor in the properties transferred. The Court said in part:

> ". . . In defining 'reorganization', section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure, but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption. Reorganization presupposes continuance of business under modified corporate forms.
>
> . . . As no stock was issued against the transfer, the conditions for an exemption were not fulfilled unless the notes, all payable within fourteen months

> of the date of the transfer, and all unsecured, can be considered 'securities' under section 203 (e). Inasmuch as a transfer made entirely for cash would not be enough, it cannot be supposed that anything so near to cash as these notes payable in so short a time and doubtless readily marketable would meet the legislative requirements."

Meanwhile, the Circuit Court of Appeals for the Fifth Circuit, in *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 57 Fed. (2d) 188 (March 29, 1932), which involved the same questions as the *Cortland* case, had gone further in limiting the definition of reorganization in clause (A), and the case went up on writ of certiorari to this Court, which in 287 U. S. 462 (January 9, 1933), affirmed the decision of the Circuit Court of Appeals. In this case the Pinellas Company on December 15, 1926, transferred 99 per cent. of its net assets to the Florida Company in exchange for $400,000 in cash and $1,000,000 in notes, secured by collateral and all falling due by April 1, 1927, and distributed to its stockholders the cash and the proceeds of the notes as they were paid, thereupon being dissolved. This Court held that the transaction was a sale for the equivalent of cash, and not an exchange for "securities", and accordingly was taxable. It was immaterial, therefore, whether or not there was a "reorganization", but the Court went on to disapprove the narrow construction of "reorganization" adopted by the Circuit Court of Appeals, saying (italics ours):

> "The court below held that the facts disclosed failed to show a 'reorganization' within the statutory definition. And, in the circumstances, we approve that conclusion. But the construction which the court seems to have placed upon clause A, paragraph (h) (1), § 203, we think is too narrow. *It conflicts with*

established practice of the tax officers and if passed without comment, may produce perplexity.

The court said—'it must be assumed that in adopting paragraph (h) Congress intended to use the words "merger" and "consolidation" in their ordinary and accepted meanings. Giving the matter in parenthesis the most liberal construction, it is only when there is an acquisition of substantially all the property of another corporation in connection with a merger or consolidation that a reorganization takes place. Clause (B) of the paragraph removes any doubt as to the intention of Congress on this point.' (57 F. (2d) 190.)

The paragraph in question directs—'The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).' The words within the parenthesis may not be disregarded. They expand the meaning of 'merger' or 'consolidation' so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness cannot be designated as either merger or consolidation. But the mere purchase for money of the assets of one Company by another is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation. *Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short term purchase money notes.* This general view is adopted and well sustained in Cortland Specialty Co. *v.* Commissioner of Internal Revenue (C. C. A. (2d) 60 F. (2d) 937, 939, 940). It harmonizes with the underlying pur-

pose of the provisions in respect of exemptions and gives some effect to all the words employed."

It seems clear from this Court's opinion that it definitely recognized that the question whether or not there was a reorganization did not require decision, because, even if there were a reorganization, there was no exchange of property for "securities", and that, solely because the Circuit Court of Appeals for the Fifth Circuit had seen fit to construe the definition of reorganization in clause (A), as had the Circuit Court of Appeals for the Second Circuit in the *Cortland* case, it proceeded to discuss the definition of reorganization, approving the limitation of its language to the extent and only to the extent of requiring a continuity of interest, which could be regarded as implicit in the concept of merger or consolidation under clause (A). It is important to note that, whereas clause (A) deals with mergers and similar amalgamations, clause (B) deals with segregations or corporate split-ups. The *Pinellas* and *Cortland* cases were concerned, not with clause (B), but with clause (A) of the definition of reorganization, the language of which was more susceptible to interpretation. The continuity of interest required by those decisions under clause (A) is not only expressly prescribed and limited by clause (B), but is present in this case, where immediately after the transfer the transferor corporation or its stockholders were in control of the transferee corporation.

The dissolution of the Averill Corporation after the transfer of the Monitor stock to the Averill Corporation and after the distribution of the Averill stock to Mrs. Gregory could not and did not vitiate the reorganization already accomplished. Clause (B) of the definition of reorganization requires control only "immediately" after the trans-

fer (Appendix, p. 55). In *Bamberger* v. *Commissioner*, 27 B. T. A. 785 (reversed and remanded on stipulation, 67 Fed. (2d) 983), both parties conceded the existence of reorganizations where two out of three corporations, to which another corporation had transferred portions of its assets on June 21, 1929, were dissolved on July 16, 1929. In *Hesslein* v. *Commissioner*, 21 B. T. A. 61, affirmed 53 Fed. (2d) 1081, the segregation of the Reading properties was held to have been a reorganization in the case of a stockholder who sold his right to receive the stock of the controlled corporation even before it was distributed to him. In *Federal Grain Corporation* v. *Commissioner*, 18 B. T. A. 242, 248, and *Schmieg, Hungate & Kotzian, Inc.* v. *Commissioner*, 27 B. T. A. 337, 342, momentary control was considered sufficient. See also *Evans Products Co.* v. *Commissioner*, 29 B. T. A. 992, *supra* (p. 38). So far as counsel knows, there are no decisions to the contrary.

In addition to the lack of any support in decided cases for the novel theory advanced by the Circuit Court in the present case, the canons of statutory construction all require an opposite conclusion.

It has often been held that the words of a statute should be taken in their plain popular meaning, and that unambiguous language permits no resort to extraneous considerations. Decisions in support of this proposition are cited under Point II above.

Where a statute has had a consistent practical construction, and Congress has repeatedly re-enacted the same language, the conclusion is required that such construction was not inconsistent with the intent of the statute. Decisions in support of this proposition are cited under Point IV above.

CONCLUSION

The decision of the Board of Tax Appeals was correct and that of the Circuit Court of Appeals was erroneous.

It is not an exaggeration to say that the decision of the Circuit Court in this case is revolutionary. Ever since the first enactment in the Revenue Act of 1924, and the continuance in subsequent acts with minor changes, of elaborate, precise and comprehensive provisions governing the taxability of exchanges and reorganizations, taxpayers and their counsel, and until recently the Treasury Department, have acted and advised in reliance upon the plain propositions of the statute, regarding as non-taxable, transactions within the scope of the language given its ordinary significance, and regarding as taxable, transactions outside such scope, irrespective of motives and purposes, whether of tax avoidance or otherwise. It made no difference, because the statute furnished its own definition, that many transactions within the statute were not reorganizations to a banker or to the man in the street or in the ordinary legal sense, which usually connotes the compulsion of financial difficulties.

But now, under the decision of the Circuit Court, the purpose of the transaction would become more important than what was actually done, and for the provisions of the statute would be substituted the guess of each court in each case as to whether the ultimate object of the taxpayers was within the unexpressed intent of Congress. No reorganization, whether under the 1934 Act or earlier Acts, could escape the test. It would be impossible for taxpayers safely to undertake readjustments of their affairs, when a strict compliance with the statutory provisions as they are written would be as likely to prove a trap

as a refuge. No two courts could be counted on to agree on what were permissible purposes, once having abandoned the safe and sure ground of the statutory definition.

Probably the respondent will contend that a reversal of the decision of the Circuit Court would cause a serious loss of revenue to the Government. It is just as likely to be true that an affirmance of the decision below would cause a serious loss of revenue. No one in or out of the Treasury Department can do more than speculate. A great many reorganizations which were no more "germane to the venture in hand" than the reorganization here involved, and equally as "ephemeral", have been consummated during the decade or more that the reorganization provisions have been in effect, and until quite recently practically all of these corporate readjustments have been accepted by the Treasury Department as constituting tax-free reorganizations. If the decision below should be affirmed, the taxpayers involved in these false reorganizations, having escaped taxes thereon because of the Treasury Department's misconstruction of the statute, would now be in a position to obtain further benefits by showing that the transactions were not reorganizations. On the subsequent sale of property received in such transactions, as well as for the computation of depreciation and depletion, the taxpayers would be entitled to a cost basis of market value at the date of the readjustment, and would not be limited to the cost to the transferor. In the case of readjustments in years not yet barred by the statute of limitations, it would often be more advantageous to pay taxes at the lower corporate rates for such years, than to be taxed at the higher present rates on subsequent sales of the property acquired through the readjustments. As the reorganization provisions were enacted for the purpose, not only of deferring taxation of gains in formal intercorpo-

rate transactions, but also of deferring recognition of losses until they should be actually realized by sale, in many instances of reorganizations meeting every objective, but failing in the subjective, test the taxpayers would be in a position to claim the deduction of substantial losses.

Simplicity, equality and certainty are universally regarded as desirable objectives for tax laws. A statutory provision which is construed as dependent upon motives, although it does not say so, scarcely makes for simplicity. The different taxation of two transactions identical in what was done, although with unlike motives, scarcely makes for equality. The inability of lawyers with any confidence to advise their clients that contemplated reorganizations are within or without a statute framed in the plainest language utterly destroys the certainty which Congress expressly intended. Taxpayers want, and the Treasury Department should want, not an attempt to do equity in each individual case, which is impossible in a tax law, but simplicity, equality and, above all, certainty.

The Circuit Court's rule not only is unwarranted by the language of the statute, by the expressed intent of Congress, by the consistent regulations and rulings of the Treasury Department, and by the decisions of the Courts, but also is impossible of administrative application. The decision below should be reversed.

Respectfully submitted,

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November 1, 1934.

APPENDIX

Revenue Act of 1928

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) Computation of gain or loss.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized. . . .

(d) Recognition of gain or loss.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purpose of this title, shall be determined under the provisions of section 112.

SEC. 112. RECOGNITION OF GAIN OR LOSS. . . .

(b) Exchanges solely in kind.— . . .

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. . . .

(g) Distribution of stock on reorganization.—If there is distributed in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) Same—effect on future distributions.—The distribution in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) Definition of reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) Definition of control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of

the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) Property acquired after February 28, 1913.—

. . .

(7) TRANSFERS TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer; . . .

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112 (g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; . . .

SEC. 115. DISTRIBUTIONS BY CORPORATIONS. . . .

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts

distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. . . .